

Message Text

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PAGE 01 STATE 011592

62

ORIGIN NEA-12

INFO OCT-01 ISO-00 AID-20 TRSE-00 L-03 ABF-01 EB-11 IGA-02

OMB-01 XMB-07 FRB-02 COME-00 CIAE-00 DODE-00 INR-10

NSAE-00 PA-04 RSC-01 USIA-15 PRS-01 SPC-03 /094 R

DRAFTED BY NEA/INS:JELEADER:HME

APPROVED BY NEA:SSOBER

NEA/INS:LBLAINGEN

AID/AA/ASIA:AWHITE

AID/ASIA/SA:HREES

ASIA/CD:THLUSTIG

TREAS:SCANNER(DRAFT)

L/NEA:ATBROWN

GC/ASIA:CGOLDSTEIN

M/FRM/FM:JMANION (SUBS)

EB/IFD:JRBENEDICK (DRAFT)

FM/LMD:JTGLAKAS (SUBS)

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R 181846Z JAN 74

FM SECSTATE WASHDC

TO AMEMBASSY COLOMBO

INFO AMEMBASSY NEW DELHI

C O N F I D E N T I A L STATE 011592

NEW DELHI PASS AID REGIONAL LEGAL ADVISOR O'DONNELL

E.O. 11652: GDS

TAGS: EAID, CE

SUBJECT: MOV NEGOTIATING INSTRUCTIONS

REF: COLOMBO 59; STATE 251795

1. BEGIN SUMMARY: CONSULTATIONS WITH AMBASSADOR JUST
BEFORE CHRISTMAS MAKE CLEAR WE ALL AGREE THAT IT IS TIME
TO CUT THROUGH OUR LONG-STANDING DISPUTE WITH SRI LANKA
REGARDING INTERPRETATION OF MAINTENANCE OF VALUE CLAUSE
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PAGE 02 STATE 011592

IN THREE ICA (INTERNATIONAL COOPERATION ADMINISTRATION)

LOCAL CURRENCY REPAYABLE LOANS. STATE 251795 AS
MODIFIED BY COLOMBO 59 INDICATES WE AGREE ON BACKGROUND
TO PRESENT PROBLEM. THIS TELEGRAM PROVIDES INSTRUCTIONS
WHICH WILL PERMIT YOU INITIATE NEGOTIATIONS LEADING
WE HOPE, TO QUICK AND MUTUALLY SATISFACTORY SETTLEMENT
THIS PROBLEM. FIRST STEP IN NEGOTIATIONS OUTLINED BELOW
IS TO GAIN USG-GSL AGREEMENT IN PRINCIPLE ON ACCEPTABLE
EXCHANGE RATE. WE ARE STUDYING QUESTION OF SCHEDULE
FOR REPAYMENT OF ARREARAGES, BUT CANNOT YET AUTHORIZE
NEGOTIATION ON THIS POINT. END SUMMARY

2. MOV DISPUTE REVOLVES ON DIFFERING US AND CEYLONESE
INTERPRETATION OF MEANING OF MOV CLAUSE IN ICA LOAN
AGREEMENTS (ICA/X-83-1, 83-2, 83-3). WE HAVE MAINTAINED
THAT US ENTITLED TO HIGHEST RATE WHERE MULTIPLE EXCHANGE
RATE EXISTS WHILE CEYLONESE ASSERT WE SHOULD AGREE TO
A NEGOTIATED LOWER RATE WHICH, BECAUSE OF IMF REGULATIONS,
SHOULD BE OFFICIAL RATE. US CLAIM TO FEEC'S REPAYMENT
RATE WOULD YIELD THROUGH MATURITY DATE OF LOANS (1989 -
97) ROUGHLY RS. 170 MILLION (ASSUMING CURRENT FEEC'S
RATE OF APPROXIMATELY RS. 11.5 PER DOLLAR); CEYLONESE
OFFICIAL RATE POSITION WOULD YIELD US ROUGHLY RS. 100
MILLION (ASSUMING CURRENT OFFICIAL RATE OF APPROXIMATELY
RS. 7 PER DOLLAR); AMOUNT IN DISPUTE AT PRESENT RATES
IS THUS ROUGHLY RS. 70 MILLION.

3. OUR POSITION, WHICH WE CONTINUE TO MAINTAIN, IS
THAT MOV CLAUSE IN ICA AGREEMENTS HAS SAME INTENT AS
CLAUSE IN AGREEMENTS BETWEEN GSL AND SUCCESSOR AGENCIES
TO ICA: TO OBTAIN FOR USG MOST FAVORABLE RATE OF
EXCHANGE WHEN A COUNTRY USES MULTIPLE RATE SYSTEM.
WE LACK DEFINITIVE OPINION OR HISTORICAL DATA ON
REASON FOR PARTICULAR WORDING OF ICA MOV LANGUAGE, BUT
BELIEVE IT INSERTED TO ALLOW DETERMINATION OF MOST
FAVORABLE RATE OF EXCHANGE BY NEGOTIATION AT TIME IN
LATE 1950S WHEN MANY COUNTRIES WERE USING COMPLEX
MULTIPLE EXCHANGE RATE SYSTEMS AND DEFINITION OF MOST
FAVORABLE RATE WAS OPEN TO INTERPRETATION. THIS NOT A
PROBLEM IN SRI LANKA CASE WHERE STRAIGHTFORWARD TWO-TIER
SYSTEM EXISTS.

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PAGE 03 STATE 011592

4. LOGIC OF MOV CLAUSE FOR USG IS CLEAR AND CONSTANT:
USG MUST PROTECT SELF AGAINST DILUTION OF REAL VALUE
OF CLAIMS THROUGH LOCAL CURRENCY DEVALUATION. THIS IS
TRUE IN ALL SUCH AGREEMENTS CONCLUDED WITH MANY COUNTRIES
AND NOT PECULIAR DOCTRINE WE HAVE DEVELOPED FOR APPLI-
CATION TO SRI LANKA. THIS POSITION COMMON IN TRANS-
ACTIONS BETWEEN GOVERNMENTS OR BETWEEN A GOVERNMENT AND

A PRIVATE ENTITY WHERE ONE OF PARTIES (A GOVERNMENT) HAS CONTROL OVER THE CURRENCY EMPLOYED IN THE TRANSACTION AND THE OTHER PARTY DOES NOT. THUS, WE BELIEVE THAT LOGIC OF MOV CLAUSE DICTATES AGAINST GSL CONCLUSION REPORTED IN COLOMBO 142 OF JANUARY 1973 THAT ICA AGREEMENT PERMITS DETERMINATION OF RATE OF EXCHANGE AT LEAST RPT LEAST FAVORABLE BASIS. (BEGIN FYI - UNFORTUNATELY EVEN AFTER EXTENSIVE RESEARCH WE ARE UNABLE FIND PRECEDENT EXACTLY EQUIVALENT TO ISSUE FACING US IN SRI LANKA MOV PROBLEM. END FYI)

5. NOTWITHSTANDING ABOVE VIEW, WE RECOGNIZE THAT SPECIFIC LANGUAGE OF ICA LOAN AGREEMENTS PROVIDES CEYLONSE WITH GROUNDS FOR CLAIMING THAT RATE OF EXCHANGE SUBJECT TO NEGOTIATION. NONETHELESS, WE WOULD LIKE YOU TO MAKE ONE MORE TRY TO GAIN ACCEPTANCE OUR POSITION AS OUTLINED ABOVE AND IN PREVIOUS PRESENTATIONS THIS SUBJECT, NAMELY THAT SRI LANKA SHOULD PAY ARREARAGES AND FUTURE PAYMENT OF ALL MOV LOANS AT FULL FEEC'S RATE (PRESENTLY RS. 11.5 PER DOLLAR).

6. YOU SHOULD TELL CEYLONSE THAT USG UNDER INCREASING CONGRESSIONAL SCRUTINY REGARDING MANAGEMENT OF LOCAL CURRENCY HOLDINGS AND CLAIMS. PURSUANT TO RECENT HOUSE/SENATE CONFERENCE REPORT ON AID BILL, GENERAL ACCOUNTING OFFICE HAS INITIATED DETAILED STUDY THIS WHOLE QUESTION. WE WOULD EXPECT FAILURE TO RESOLVE ISSUE PROMPTLY COULD PROMPT CRITICISM BOTH OF EXECUTIVE BRANCH AND OF FOREIGN GOVERNMENTS.

7. IF YOUR INITIAL APPROACH DOES NOT PRODUCE POSITIVE GSL RESPONSE, YOU ARE AUTHORIZED TO PROPOSE COMPROMISE SETTLEMENT IN INTEREST OF RAPID RESOLUTION OF THIS
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PAGE 04 STATE 011592

PROBLEM. YOU SHOULD EMPHASIZE TO GSL THAT WE THINK TIME IS OVER-DUE FOR NEGOTIATION TOWARD RESOLUTION OF PROBLEM. BASIS OF COMPROMISE SETTLEMENT WOULD BE THAT CEYLONSE WOULD GRANT USG HIGHER FEEC'S RATE ON ARREARAGES AND FUTURE PAYMENTS OF TWO OF THREE DISPUTED LOANS (ICA/X-83-2 (EQUAL SIGN) 3.365 MILLION DOLLARS, ICA/X-83-3 EQUALS DOLS 7.332 MILLION DOLLARS THROUGH MATURITY) WHILE WE WOULD ACCEPT OFFICIAL RATE FOR THIRD LOAN (ICA-X-83-1 EQUALLING DOLS 3.887 MILLION THROUGH MATURITY -- UNDER PROPOSED FORMULA THERE NATURALLY ARE NO ARREARAGES ARISING FROM RATE DIFFERENTIAL ON ICA/X-83-1). THIS WOULD MEAN CEYLONSE WOULD PAY RATE OF APPROXIMATELY RS. 11.5 TO ONE DOLLAR ON LOANS WORTH DOLS 10.7 MILLION EQUIVALENT THROUGH MATURITY, AND RATE OF APPROXIMATELY RS. 7 TO ONE ON LOAN WORTH DOLS. 3.9 MILLION EQUIVALENT. PRACTICAL

EFFECT WOULD BE COMPROMISE RATE OF ABOUT RS. 10 TO ONE DOLLAR. IN FINDING SETTLEMENT ON THIS BASIS, USG AND GSL WOULD THUS BE PUTTING ASIDE QUESTION OF INTERMEDIATE RATE IN ORDER TO PREVENT TECHNICAL PROBLEM FROM ARISING WITH IMF ON THIS COUNT. WE UNDERSTAND FROM US EXEC DIR TO IMF THAT REPAYMENT OF TWO LOANS AT DIFFERENT RATES WOULD NOT RPT NOT POSE PROBLEMS FOR SRI LANKA WITH IMF SINCE THIS PROCEDURE WOULD NOT ESTABLISH A THIRD RATE OF EXCHANGE.

8. WE ARE NOT RPT NOT YET PREPARED TO DISCUSS WITH CEYLONSE EXTENDED SCHEDULE FOR REPAYMENT OF ARREARAGES SHOULD CEYLONSE EXPRESS INTEREST IN THIS. IN PREVIOUS PREPARATION FOR NEGOTIATIONS (CA-1572, NOVEMBER 17, 1972) WE AUTHORIZED REGROUPING OF ARREARAGES, IN SEPARATE SCHEDULE FROM REGULAR PAYMENTS, TO BE AMORTIZED OVER FOUR YEARS. INCREASED SCRUTINY OF GENERAL QUESTION DEBT RESCHEDULING ON HILL AND IN EXECUTIVE BRANCH REQUIRES WE STUDY CAREFULLY ANY PROPOSAL FOR DEBT REPAYMENT WHICH COULD BE CONSTRUED AS DEBT RESCHEDULING. EMBASSY REQUESTED NOT TO RAISE QUESTION OF REPAYMENT SCHEDULE FOR ARREARAGES. IF CEYLONSE RAISE IT SAY THAT YOU HAVE NO INSTRUCTIONS ON THIS QUESTION, AND WILL HAVE TO REFER IT TO DEPARTMENT. IN MEANTIME, WE WILL BE STUDYING QUESTION AND HOPE TO GIVE YOU EARLY AUTHORITY TO INCLUDE PAYMENT SCHEDULE IN YOUR NEGOTIATIONS. AS
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PAGE 05 STATE 011592

YOU AWARE, ANY SETTLEMENT WHICH MODIFIES TERMS OF LOAN AGREEMENT (E.G., RESCHEDULING ARREARAGES) WILL HAVE TO BE SUBMITTED TO APPROPRIATE WASHINGTON AUTHORITIES FOR FORMAL APPROVAL. FOREGOING PROPOSAL ON EXCHANGE RATE DOES NOT ALTER TERMS OF LOAN AGREEMENT WHICH CALLS FOR EXCHANGE RATE AS MUTUALLY AGREED. RUSH

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